WORKING PAPER SERIES

A MULTILATERAL INVESTMENT ACCORD: ISSUES, MODELS AND OPTIONS

Working paper number 8
June, 1991

INVESTMENT CANADA
INVESTISSEMENT CANADA

MANDATE

The mandate of Investment Canada is to (1) promote investment in Canada by Canadians and non-Canadians, (2) undertake research and provide policy advice on matters relating to investment, and (3) review major foreign investments to determine if they are likely to be of net benefit to Canada.

Investment Canada's working papers are published by the Agency's Investment Research and Policy Division for information and discussion. This Division monitors investment trends in Canada and abroad, studies various investment-related issues such as globalization and the behaviour of multi-national firms, and provides policy advice and analysis to the Minister responsible for Investment Canada. The working paper series seeks to inform interested Canadians about investment issues and to foster a better understanding of the role and importance of international investment in the Canadian economy.

WORKING PAPER SERIES

A MULTILATERAL INVESTMENT ACCORD: ISSUES, MODELS AND OPTIONS

by Strategico Inc., under contract with Investment Canada

Working paper number 8
June, 1991

Comments should be addressed to:

Emmy Verdun
Director, Investment Policy
Investment Canada
P.O. 2800, Station D
Ottawa, Ontario
K1P 6A5
Telephone : (613) 995-9603

Aussi disponible en français

The views expressed in these working papers do not necessarily reflect those of Investment Canada or of the federal government. Details of the titles available in the Working Paper Series and how to obtain copies can be found at the end of this document.

91-05847/

TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION 1

THE INTERNATIONAL INVESTMENT ENVIRONMENT 2
- Dominance of the Triad 2
- Globalization 3
- The New Complexion of Investment Issues 6
  - (a) Structural impediments 6
  - (b) Non-tariff barriers 7
  - (c) Strategic trade policies 8
- The Point of Diminishing Returns 8
- Global Competition for Capital 12
- The Investment Environment 13

EXISTING INSTRUMENTS GOVERNING INTERNATIONAL INVESTMENT ... 13
- (a) Bilateral investment treaties 14
- (b) Specialized international agencies 14
- (c) The UN Draft Code of Conduct 14
- (d) The OECD 14
- (e) The GATT 15

LESSONS FROM THE CANADA-U.S. FREE TRADE AGREEMENT 17
- National Treatment and Right of Establishment 17
- "Acceptable Deviations" 18
- Extraterritoriality 18
- Reporting Requirements 19
- Performance Requirements 20
- Investment Incentives 20
- Nearby Domains 20
- Dispute Settlement 21

NEGOTIATION OF A NEW ACCORD 22
- (a) An OECD investment agreement 24
- (b) A World Trade Organization agreement 25
- (c) Investment accords between trade blocs 26

CONCLUSION 28

APPENDIX A: STATUS AND PURPOSE OF SIGNIFICANT MULTILATERAL INVESTMENT ARRANGEMENTS AND AGREEMENTS 31
- Specialized Agencies and Facilities 31
- UN Draft Code of Conduct on Transnational Corporations 31

Bilateral Investment Treaty Programs 32
OECD Codes of Liberalization 32
The GATT 33

APPENDIX B: DISPUTE SETTLEMENT MECHANISMS 35
FTA - Chapter 18 35
GATT 35
OECD 35
International Convention on the Settlement of Investment Disputes 36

INVESTMENT CANADA WORKING PAPER SERIES 37

EXECUTIVE SUMMARY

The rapidly changing global economic and political environment has given rise to a number of new international investment policy issues that are not amenable to traditional policy approaches. Meanwhile, the point of diminishing returns may have been met with respect to the removal of traditional barriers to investment flows. Despite these factors, the objective of liberalizing capital flows remains legitimate on both theoretical and practical grounds.

The lessons of the Canada-U.S. Free Trade Agreement and the European Common Market are that trade and investment liberalization should proceed hand-in-hand. This is especially true if the "new" investment issues (arising from investment related trade measures, structural impediments, and strategic trade policies) are to be successfully contained.

Three main alternatives for a new multilateral initiative to address both old and new investment issues are: (1) revitalizing the OECD; (2) placing investment more definitively under the auspices of the GATT, perhaps through the instrumentality of a World Trade Organization (WTO); (3) promoting a substantive negotiation on investment between two of three members of the Triad — the dominant trading blocs of Europe, the United States and Japan.

The second option would be the most in line with Canada's traditional approach to trade and investment liberalization in the postwar era, although to date there has not been widespread support for a World Trade Organization. Option (1), revisiting the OECD as an institutional forum for the negotiation of an investment accord, has considerable merit, given the Organization's relative neutrality in the Uruguay Round of Multilateral Trade Negotiations and its in-house store of knowledge concerning many of the relevant issue areas. The third option, a new investment accord between two members of the Triad, is the least desirable from Canada's viewpoint, because Canada's ability to influence the scope and content of such a negotiation could be expected to be marginal at best.

INTRODUCTION

Over the past decade a number of commentators have spoken of the need for a new multilateral accord on international investment. With the outcome of the Uruguay Round of Multilateral Trade Negotiations uncertain, and in the context of significant structural changes in the international economic and political system, it is appropriate now to review the public policy rationales for such an initiative.

This report suggests that changes in the structure and operation of the global economy have given rise to a number of new international investment policy issues that are not amenable to traditional approaches. Meanwhile, removing the traditional barriers to investment flows may have met the point of diminishing returns. Despite these factors, the objective of liberalizing capital flows remains legitimate, both on theoretical and on practical grounds.

In the past, the greatest progress on investment issues has occurred within free trade areas and within the European Common Market. For this reason, provisions in the investment chapter of the Canada-U.S. Free Trade Agreement (FTA) might be expected to serve as one potential model for a new multilateral investment accord. However, while several features of the investment provisions are of interest, its simple application in a multilateral context would be neither feasible nor effective. Moreover, the real lesson of the FTA (and, for that matter, the European Common Market) is that the liberalization of capital movements must go hand in hand with trade liberalization.

This report reviews current informed opinion on shaping a new multilateral investment accord, first describing the predominant features of today's international investment environment and relevant policy issues. It goes on to look at the status and efficacy of existing multilateral instruments for addressing investment issues. The third section examines Chapter 16 of the Canada-U.S. FTA as one model for a new international investment accord. The insights from this exercise are drawn upon in the final section to define the range of possible options for a multilateral investment accord.

THE INTERNATIONAL INVESTMENT ENVIRONMENT

The past two years have seen the publication of a number of commentaries on the shape of the global economy in the post-cold war era. Major policy themes that have been introduced include the following:

- A Triad of trading blocs made up of Europe, the United States and Japan has come to dominate in the economic sphere. The economic and political dynamics among the three pose new threats to an open global trade and investment system, including new forms of protectionism.
- The process of "globalization" continues apace. Transnational flows of investment, technology and, to a less pervasive extent, trade, are increasing the interdependence of national economies and strengthening multiple linkages between consumers, producers, suppliers and governments in different countries.
- Momentum for multilateral trade and investment liberalization under existing institutional arrangements has been largely spent.
- A global credit squeeze is emerging, with adverse implications for sustained economic growth in the 1990s.

As described below, these themes serve to highlight those features of today's political and economic environment that give much of the character to the international investment policy issues we now face.

Dominance of the Triad

The dominant line of thinking among policy makers is that, with the decline in the relative power of the Soviet Union and the continuing incremental decline in the economic power of the United States, the world economy has become tripolar. The "Triad" powers of the United States, the European Economic Community and Japan constituted the main economic constellation in the world prior to the fall of the Berlin Wall (see Figure 1), but the political dynamics between members of the Triad were governed by the power struggle between East and West.

The full implications of the East-West detente for the economic relationships within the Triad are not yet clear. In the view of some observers, economic conflict among them is likely to increase,[1] if only because in any three-party system two members have a tendency to gang up on the third. This view is complicated by other

---

[1] See, for example, John J. Mearsheimer, "Why We Will Soon Miss the Cold War", in The Atlantic Monthly, August 1990, 35-50, and C. Fred Bergsten, "The World Economy", in Foreign Affairs, Summer 1990, 96-112.

considerations relating to the roles played by countries and political developments external to the Triad. For example, the situation in the Middle East and the political and economic disintegration of the Soviet empire are continuing uncertainties.

The idea of a powerful Triad is nevertheless having great influence on international economic and, perhaps more obliquely, on security policies.

In a recent presentation, Charles Doran, the noted political scientist, has drawn a distinction between the commercial decisions of individual firms and the larger geostrategic assessments of governments.[2] Doran notes that, with the emergence of a truly independent Europe, North American firms are jumping protectionist barriers and locating their operations inside Europe. The U.S. government meanwhile is floating the idea of a free-trade zone encompassing North and South America that would have more than comparable clout in world trade negotiations. According to Doran, the U.S. government's ruminations indicate more than economic expediency. They show strategic re-thinking whereby new U.S. initiatives are required to maintain a notion of equality between the United States and a politically independent Europe.

With these observations in mind, it would be naive to suppose that any economic policy initiatives are divorced from larger considerations relating to national power and negotiating leverage. The only reason the United States would consider a new multilateral investment accord would be if such an accord provided greater leverage in future dealings with Japan and Europe on a whole range of issues.

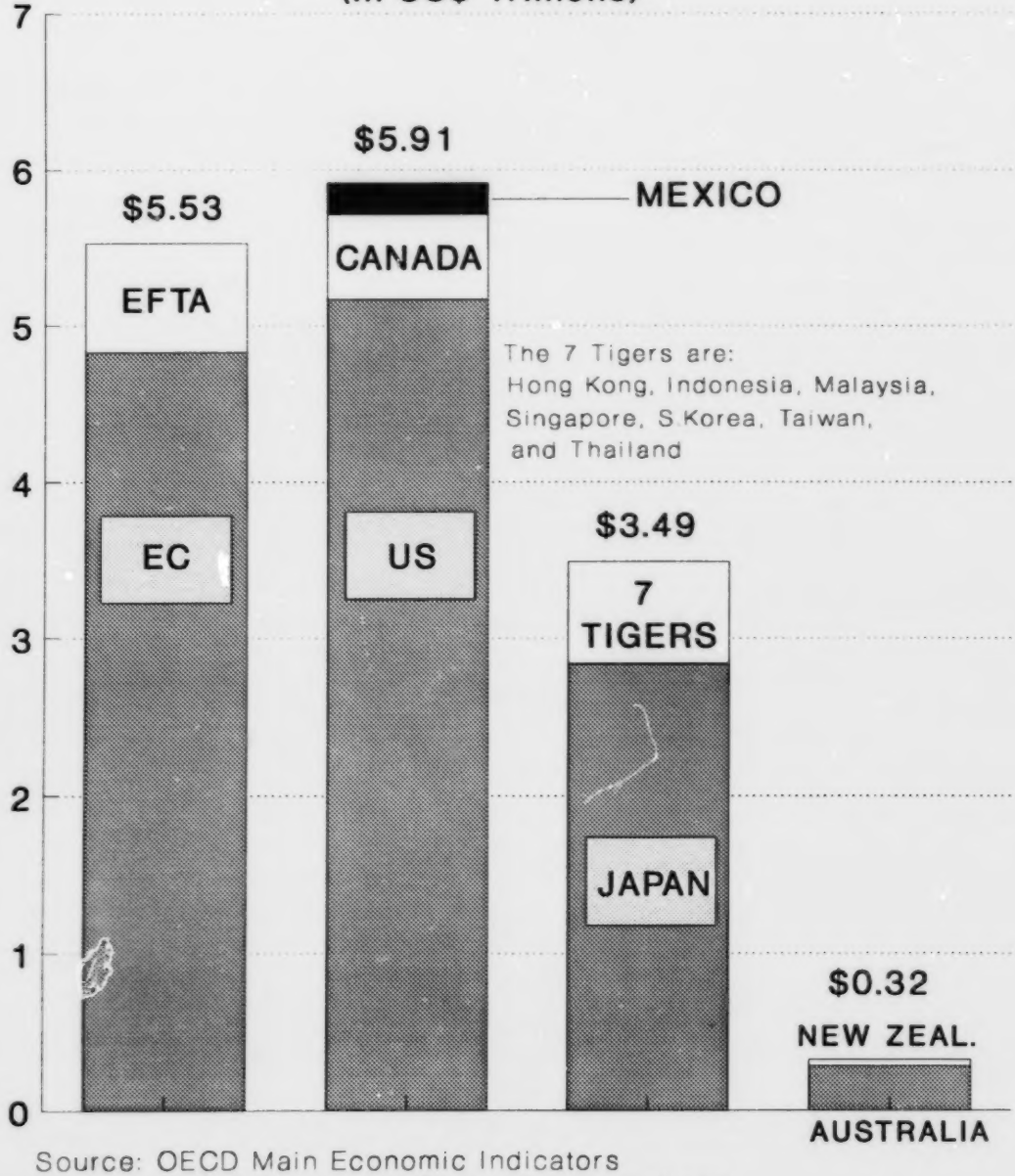
Globalization

The ongoing process of globalization is a second major theme current within the public policy community. One recent study has defined the process of globalization in the following terms:

> Globalization has been a gradual process. It is not possible to pinpoint a particular year or even a particular decade, and say "this is when globalization occurred". We can, however, trace the evolution by identifying milestones which, together, have contributed to a fundamental change in the overall environment. Changes include: the rapid increase in world trade and the openness of economies; the development of instant communications around the world; the

[2] Charles F. Doran, "North America and Europe: The Future of Transatlantic Relations," presentation made August 17, 1990 at the conference The Road from Ogdensburg: Fifty Years of Canada-U.S. Defense Cooperation, Canton, New York.

Figure 1
Gross Domestic Product of the Triad
1989
(In US$ Trillions)



Source: OECD Main Economic Indicators
Business Asia, Business International,
Bank of Mexico

growth in international capital markets; the growth in foreign direct investment; the emergence of global corporations; and the growing attempts [by] government to coordinate economic policies.[3]

The term "globalization" is, therefore, applied to a number of disparate phenomena, and for that very reason it is a somewhat unsatisfactory concept. However, it is not entirely without merit, particularly if it is defined in terms of the internationalization of capital (including modes of corporate organization and activity). The internationalization of capital is both a key indicator of globalization and a prime mover of that process. In this regard, the following trends in foreign direct investment (FDI) are significant.[4]

- Foreign direct investment has overtaken trade as a source of growth. Global FDI flow increased by over 20 percent per annum between 1983 and 1988, compared to growth in world trade volumes of 5 percent per annum over the same period.

- The OECD area remains the dominant source and recipient of FDI flows and reinforces the Triad as the centre of the economic policy world. (Globalization may not be so global after all.) Recent estimates, for example, suggest that the G-5 countries alone accounted for over 75 percent of the world's total FDI flows in 1988. The stock of FDI in less developed countries (LDCs) has actually diminished in real terms since the 1970s.

- The service sector has been the driving force for FDI growth in the 1980s. In 1988, the share of services in total outward FDI of the G-5 nations ranged from 31 percent for Germany to a high of 58 percent for Japan. The internationalization of capital should not lead to the conclusion that national competitive advantage (as distinct from comparative advantage) is no longer a relevant consideration. Senator J. Trevor Eyton recently underlined this point when he said:

. . . With the increasing globalization of business activity, firms will have to compete more and more with companies operating in different national environments. The positive and negative features of these environments will become key factors in achieving commercial success, both in home markets and internationally. Put another way, the new global competition between companies

---

[3] The Business Implications of Globalization, Investment Canada Working Paper No. 1990-V, May, 1990.

[4] DeAnne Julius, Global Companies and Public Policy (New York: Council on Foreign Relations Press, 1990), 20-44.

reflects a broader underlying rivalry between competing national economic systems.[5]

The relationship between globalization and the fact of a continuing struggle between competing national economic systems is fundamental to understanding the international trade and investment policy environment today.

There is nothing new about competition between national economic systems. What is new is that as economic interdependence between nations has increased because of globalization — which includes the progressive removal of "traditional" barriers to the free flow of capital, goods, services, and technology — differences in the structural characteristics of national economies have increasingly become one locus for conflict.

The New Complexion of Investment Issues

A third major policy theme is that the complexion of international trade and investment policy issues has significantly changed over the past decade.

Since the mid-1970s, the volume of trade has continued to grow, but at a slower rate in relation to global output than before. As concluded by *The Economist*: "That is a sign that something is amiss. The cause is not hard to find. The past 15 years have seen a proliferation of new sorts of trade protectionism."[6] Many analysts have described the range of measures that have been introduced as part of the new protectionism. These may be generally categorized as:

- structural impediments,
- non-tariff barriers, and
- strategic trade policies.

It is notable that the new protectionist measures are relevant not only to international trade flows, but also to international direct investment flows.

(a) Structural impediments

Barriers to the free flow of capital are increasingly defined in terms of broader policy issues arising from divergence in the structure of national economies. To date, the structural impediment critique has largely been launched by U.S. businesses and commentators, and has been aimed primarily at trade and investment access to Japanese

---

[5] J. Trevor Eyton, "Changes in the International Trading Environment and Canada's Competitive Position," address to the Canadian Exporters' Association Annual Convention, 1990, Halifax, Nova Scotia, October 1, 1990.

[6] "Nothing to Lose But its Chains — A Survey of World Trade", The Economist, 22-28 September, 1990.

markets. As summarized in a recent Investment Canada working paper,[7] among the frequently cited elements of the "structural impediments" critique are the following:

- The Japanese *keiretsu* system ensures that only a low percentage of company stock is for sale on the stock market. A *keiretsu* tends to bind a group of companies together through extensive cross-shareholdings, other financial ties and complementary business strategies.
- Japanese employment practices, which are geared to keeping employees with one firm for life, make it almost impossible for foreign investors to hire good Japanese management personnel from other firms.
- Japan's complex distribution system supports thousands of small and allegedly inefficient retail operations through just-in-time delivery and consignment sales.
- The rise in land prices in Japan has had the effect of creating barriers against new business entrants, including foreign businesses.

Such complaints suggest a negotiating agenda more diffuse than that typically addressed within existing multilateral forums. It embraces not only formal barriers to investment but also a number of nearby investment-related domains including competition policy, procurement measures, social and business policy practices and norms, and fiscal and monetary policies. It is notable that, in response to complaints about the Japanese system, the U.S. government has relied on a new bilateral instrument, the Structural Impediments Initiative (SII), to address perceived problems.[8]

(b) Non-tariff barriers

Non-tariff barriers (NTBs) to trade and the use of existing trade remedy laws are frequently pointed to as the source of distortions in capital flows. The NTBs that are most effective relate to market access. For example, the extent and form of Japanese investment in Europe are being determined by considerations relating to the EEC'S application of rules of origin and anti-dumping measures.[9] Exporters to Japan face an added problem. Not only are they denied market access, but they also have difficulty in overcoming that barrier through direct investment.

---

[7] Ash Ahmad and John Knubley, Barriers to Foreign Direct Investment in the G-7 Countries, Investment Canada Working Paper, (forthcoming).

[8] On June 28, the U.S. and Japan announced the final report of the Structural Impediments Initiative in which Japan agreed to a substantial increase in public infrastructure investment and measures to curb exclusionary business practices. See: "U.S., Japan Announce Final Structural Impediments Initiative Package," Inside U.S. Trade, June 29, 1990.

[9] Sylvia Ostry, Governments and Corporations in a Shrinking World (New York: Council on Foreign Relations Press, 1990).

(c) Strategic trade policies

The increasing recourse by governments to policy instruments justified by the theory of strategic trade policy is a matter of concern because these instruments affect both trade and investment.

The theory of strategic trade policy has been developed to counter the consequences of imperfect competition. One strand of the theory claims that, in trade categories dominated by a small number of large firms, government intervention can secure a bigger share of any available rents (returns in excess of economic costs) for a country's own producers. A second strand suggests that firms are unable to capture the benefits of expensive innovation and that they therefore require government intervention.[10]

Sylvia Ostry and other commentators have noted that the theory of strategic trade policy has attracted growing criticism, particularly with respect to its implications for trade policies.[11] A practical consideration is that this theory is providing intellectual justification for government intervention in trade-sensitive sectors, especially high technology. Such intervention is, in the view of many commentators, exacerbating problems of market access and causing trade and investment distortions.

Table 1 indicates the form and magnitude of the type of government support in Europe, the United States and Japan for technical innovation projects that are the subject of concern.

The Point of Diminishing Returns

A fourth important policy theme is that existing multilateral institutions, such as the GATT and the OECD, have been effective for the problems for which they were designed, but are inadequate for the new tasks at hand.

Under the auspices of the GATT, the traditional barriers to trade and investment have been substantially dismantled since the second world war. With respect to trade, governments have cut the average tariff on manufactured goods from 40 percent in 1947 to approximately 5 percent today. During the same period, world trade has expanded by 500 percent by volume (vs. an increase in global output of 200 percent).[12]

---

[10] The Economist, "Nothing to Lose."

[11] Ostry, Governments and Corporations.

[12] The Economist, "Nothing to Lose".

Table 1
Government Support for High Tech Consortia in Europe, the United States and Japan

Pan-European technical initiative	Key projects, consortia, or research thrusts	Approximate total funding, in U.S. dollar millions (percent from government sources)	Number of projects or consortia within initiative	Year formed
Europe				
European Strategic Program for R&D in Information Technology (Esprit)	Supermode II microelectronics, information processing, advanced business and home systems, computer-integrated manufacturing and engineering	4200 (50%) [Esprit II]	More than 400 [Esprit II]	1983
European Research Cooperation Agency (Eureka)	Joint European Submicron Silicon Initiative (Jessi), Prometheus (automotive technology), High-Definition Television (HDTV)	8000 (about 30%)	370	1985
Research and Development in Advanced Communications in Europe (RACE)	Broadband local network technology (R1012), HDTV switching (R1013), mobile telecommunications (R1043), integrated broadhand communications (R1044), advanced telecommunications for manufacturing (R1039)	1600 (less than 50%)	90	1985
Basic Research for Industrial Technology in Europe (Brite) and European Research in Advanced Materials (Euram)	Superconducting materials, testing techniques, computer-assisted techniques in manufacturing, advanced mathematical modelling of industrial processes, advanced manufacturing, advanced materials aeronautics	1300 (50%)	490 (since 1985)	1985 (Brite) 1986 (Euram)

Source: Institute of Electrical and Electronics Engineers, Inc., *Spectrum*, October 1990

Table 1 (Continued)
Government Support for High Tech Consortia in Europe, the United States and Japan

Consortium	Main areas of investigation	Annual budget in U.S. Dollar millions (percent from government sources)	Number of members	Year formed
United States				
Semiconductor Manufacturing Technology (Sematech)	Semiconductor materials and fabrication techniques	200 (50%)	14	1987
Microelectronics and Computer Technology Corporation (MCC)	Advanced computing, computer software, computer-aided design, computational physics, electronics packaging and interconnections	65 (0%)	20	1983
Semiconductor Research Corporation (SRC)	Semiconductor technologies and fabrication, computer-aided design circuit models and devices, manufacturing systems	28 (2%)	27 (plus 2 associates, 9 affiliates and 6 Government agencies)	1982
Microelectronics Center of North Carolina (MCNC)	Microelectronics, telecommunications, supercomputing	30 (65% from North Carolina)	70 companies, 9 universities, 1 research institution	1980
Consortium for Superconducting Electronics (CSE)	Electronics applications of superconductive films	15 (50%)	4 (plus 2 subcontractors)	1989

Table 1 (Continued)
Government Support for High Tech Consortia in Europe, the United States and Japan

Consortium	Main areas of investigation	Annual budget in U.S. Dollar millions (percent from government sources)	Number of members	Year formed
Japan				
Synchroton Orbital Radiation Technology Center (Sortec)	Microlithography, SOR applications	12 (30%)	14	1986
Optoelectronic Technology Research Corporation (OTRC)	Optoelectronic materials	7 (70%)	14	1986
Institute for New Generation Computer Technology (ICOT)	Advanced computer architectures, hardware and software for artificial intelligence	47 (100%)	10	1982
The Realtime Operating Nucleus (TRON)	Computer software, hardware, architecture	No common budget; members coordinate R&D fund allocation	142	1984
International Superconductivity Technology Center (Istc)	Superconductivity	17 (33%)	111	1988

The removal of formal barriers to foreign direct investment is more difficult to measure, but has also been substantial. As noted in the OECD's June 1990 report *Progress in Structural Reform*:

> The increased globalization of production, together with a reduction in barriers to foreign direct investment (FDI) has encouraged a renewed surge in FDI in the last two years. Investment flows within the OECD area have become more balanced, in that a greater number of countries are involved as both host and source country. More countries have realized the advantages that FDI can bring and have adopted policies to increase their attractiveness to foreign investors. Canada, Ireland, Portugal and Spain, for example, have reduced local content or export requirements imposed on foreign investors. And where formal measures regarding inward investment are retained, they are often tending to fall into disuse. Nevertheless, there remain restrictions relating to traditionally sheltered areas, such as transport, communications and the media.[13]

Although great progress has been made towards the objective of removing the "traditional" barriers to trade and investment since 1947, further substantial progress is not expected to occur under existing institutional regimes. For example, the "traditionally sheltered" areas of transport, communications and the media are proving to be highly resistant to liberalization. With respect to broader trade issues, the views expressed by Gary Hufbauer in late 1989 are germane. Hufbauer noted that even if the Uruguay Round of Multilateral Trade Negotiations does not collapse, the world will still be left with major impediments to trade both at and within national borders.

Once the Uruguay Round is complete, it would be fair to characterize a follow-up round of GATT talks as a quest for the Holy Grail: the objective is worthy, but no one should expect the ultimate goal — trade liberalization in a world free of non-tariff measures and investment barriers — to be reached by further GATT talks.[14]

Global Competition for Capital

Efforts to manage the new investment issues are taking place in an increasingly difficult macro-economic environment. Since 1987, a global credit squeeze has emerged. New demands for credit are being made by clients (i.e., Eastern Europe and the Soviet Union), as well as larger demands from traditional borrowers (e.g., financing for the $300 billion U.S. deficit and retrenchment by Japanese banks and investors after the financial excesses of the 1980s). The critical macro-economic issue facing finance ministers is how

---

[13] "Progress in Structural Reform," Supplement to OECD Economic Outlook No. 47 (Paris: OECD, 1990), 9.

[14] Gary Hufbauer, "Beyond GATT", in Foreign Policy, No. 77, Winter 1989-90, 64-76.

to ensure that the international financial system will generate enough new credit to finance both old and new demands for capital while maintaining economic expansion.

The Investment Environment

This review of major international political and economic policy themes suggests that global developments over recent years pose complex challenges, none of which is amenable to easy solution. The dominant Triad of economic groupings — Europe, the United States and Japan — is seen as driving public policy decision-making on matters economic. At the same time, the forces of globalization have tended to heighten competition between the members of the Triad and increased the salience of structural differences between national economies as a consideration in national competitive advantage.

Globalization has been propelled by the reduction of traditional barriers to trade and investment, but further reductions are not likely to take place. Moreover, a number of new investment issues could in fact prove to be even greater hindrances to liberalizing investment flows. These issues relate to conditions of market access, to differing structural features of national economies and modes of government domestic regulation, to the increasing recourse by individual countries and trading blocs to "strategic trade policies" (including important elements of competition and innovation policies) and, more generally, to the investment-distorting impact of trade measures. One major question that should be addressed is whether existing multilateral institutions and instruments for addressing international investment issues are adequate to meet the new challenges.

EXISTING INSTRUMENTS GOVERNING INTERNATIONAL INVESTMENT

Since the late 1940s, international investment issues have been the object of attention within a variety of institutional forums and between individual nations. Among the more significant institutions, instruments, and initiatives are:

- bilateral investment treaty programs;
- specialized international agencies and facilities for protecting investments and settling disputes;
- the United Nations Draft Code of Conduct on Transnational Corporations;
- OECD Codes of Liberalization and related decisions and declarations; and
- the Uruguay Round of Multilateral Trade Negotiations (under the auspices of the General Agreement on Tariffs and Trade).

(a) Bilateral investment treaties

Existing bilateral investment treaties (of which there are over 250) have typically been negotiated between industrialized countries and less developed countries (or, more recently, the transitional economies of Eastern Europe and the Soviet Union), and their objective is primarily to protect a country's investments. The treaties are not prospective instruments for investment liberalization, and they certainly do not provide any kind of model for addressing the new array of investment issues.

(b) Specialized international agencies

The Multilateral Investment Guarantee Agency (MIGA) and the International Convention for the Settlement of Investment Disputes have been used primarily to address investment protection issues between industrialized and developing countries and their nationals. They have extremely narrow mandates and, while effective in achieving their stated aims, they have not been key instruments for achieving the liberalization of capital movements in the postwar era.

(c) The UN Draft Code of Conduct

Negotiations on the United Nations' Draft Code of Conduct, which have been going on since the 1970s, have now reached a stalemate. The objective of the Code was to provide a stable, predictable and transparent framework that would facilitate the flow of resources across national boundaries and thereby enhance the role of foreign investments in economic and industrial growth. At the same time, the Code is meant to minimize any negative effects associated with the activities of transnational corporations.[15] The emphasis on controlling the behaviour of transnational corporations has, in large part, been the cause of the stalemate and reflects the continued preoccupation by some LDCs with advancing a largely discredited model of economic development.

(d) The OECD

The OECD has provided an important forum where the industrialized market-economy countries could address investment issues in the postwar era. The OECD has also served as a forum for research and discussion on such investment-related issues as restrictive business practices, extraterritoriality, taxation, export controls, and trade-related investment measures.

The OECD Codes of Liberalization (of Capital Movements and of Current Invisible Operations) are legal instruments through which members commit themselves to a process of progressive liberalization. The Code of Liberalization of Capital Movements addresses the issue of the right of establishment. When members subscribe to the Code,

---

[15] For a succinct description of the U.S. position on the draft code, see "International Direct Investment, Global Trends and the U.S. Role" (Washington: U.S. Department of Commerce, 1988), 80-81.

they commit themselves to progressive liberalization, but are permitted to lodge "reservations" that allow them to list their exceptions to the Code. The reservations are subject to periodic examination by the Committee on Capital Movements and Invisible Transactions.

There are no economic or financial penalties for non-compliance with the Code; moral suasion is used instead. This factor has led to some scepticism about the efficacy of the OECD and the Codes in the promotion of the liberalization of capital movements. Although OECD members have significantly liberalized their policies on inward direct investment since the Capital Movements Code was introduced, it is not clear whether the OECD has played a substantial role in this process.

The OECD is now discussing strengthening a National Treatment Instrument whereby governments would commit themselves to not discriminating between domestic investors and foreign investors once established. At present in the OECD, the principle of national treatment does not have the same status as a Code (which is recognized by members as a legally binding obligation). Progress on the National Treatment Instrument has been slow, although it will likely be put forward to the OECD Council in May of 1991 for formal approval. However, no one is suggesting for a moment that the Instrument will dramatically change the existing situation with respect to remaining investment reservations made by member governments.

(e) The GATT

At Punta del Este in 1986, Trade Related Investment Measures (TRIMs) were placed on the agenda of the Multilateral Trade Negotiations (MTN) being carried out under the auspices of the GATT. This marked the first time in a multilateral forum that trade and investment issues had been addressed together. During the session, the trade Ministers of contracting parties to the GATT declared that:

> Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.[16]

By the time of the Ministerial meeting in Brussels in early December, 1990, however, it was evident that the actual negotiated outcome on TRIMs might be rather limited. Although the negotiating group on TRIMs had managed to narrow the number of issues on the table (primarily by dropping several of the more contentious proposals made by developed and developing countries), major philosophical differences remained for Ministerial consideration. For example, no agreement was reached on whether

[16] Ministerial Declaration, Punta del Este, 1986.

specified TRIMs should be proscribed by a TRIMs code or whether they should be the subject of case-by-case actions. Similarly, there was no consensus on whether requirements (either de jure or de facto) imposed on investors once established should be included in any agreement.[17]

Should the MTN be restarted, Ministers are not likely to become deeply involved in a potentially acrimonious debate on TRIMs in an already delicate negotiating context dominated by the intractable issue of agricultural subsidies. Although the December 1990 suspension of negotiations was not an announcement of the GATT's demise, it was yet another indicator that only modest progress for further liberalization can be expected under the current structure and operation of the GATT.

The existing instruments governing international investment exhibit many of the same weaknesses that have been associated with the current state of the General Agreement on Tariffs and Trade.[18] In particular:

Exceptions. For the OECD codes, grandfather rights for exceptions (sometimes extremely wide exceptions) remain in place for signatories.

Institutional Fragmentation. Investment issues are addressed in a variety of forums, and the functional and operational relationships between them are not always clear-cut (e.g., the Canada-U.S. Investment Chapter and the OECD Codes).

Membership. The complexity of accommodating diverse governments under different membership rules has contributed to the perception of inequality in the application of international investment rules (e.g., the U.S. BIT program as applied to developing nations) and increased suspicions respecting national motives for entering into investment agreements.

Dispute settlement. The existing dispute settlement process is fragmented and uneven in coverage (indeed, non-existent in the case of the OECD Codes).

Amending provisions. The amending provisions of the GATT and the OECD are time-consuming and prevent the evolution of rules for the accommodation of constant change and developments in the international economic environment.

These findings on the status of existing (and, in the case of the United Nations and the GATT, prospective) instruments and institutions for the liberalization of capital

---

[17] "GATT Members Seek to Narrow Differences over Draft Investment Agreement," Inside U.S. Trade, November 23, 1990.

[18] "Proposal for a World Trade Organization: Concept and Perspective," Department of External Affairs and International Trade, August, 1990. See also: John H. Jackson, Restructuring the GATT System (New York: Council on Foreign Relations Press, 1990).

movements are not encouraging, at least in terms of the development of a comprehensive and coherent multilateral framework for international investment to address the new investment issues. While several of the key instruments and institutions worked well in the past for the specific problems they were designed to address, they are not charged with a mandate sufficient to deal with a world where investment issues are increasingly linked with issues of market access, national innovation and competition policies, and structural differences between national economies.

LESSONS FROM THE CANADA-U.S. FREE TRADE AGREEMENT

In the postwar era, the most substantive commitments to the liberalization of capital movements and, in particular, direct investment, have been made within the context of bilateral free trade agreements and the European Common Market. For this reason, it is relevant to take note of the interest expressed in taking the investment provisions of these agreements as a model for a new international investment accord.

In their 1989 study *Foreign Direct Investment in the United States*,[19] Edward Graham and Paul Krugman put forward a proposal for a new accord on investment and multinational enterprise that would, initially, involve the world's largest industrialized nations. The authors suggest that Chapter 16 of the Canada-U.S. FTA might serve as a model for such a new accord.

The specifics of the Graham-Krugman proposal embrace both more and less than the FTA's investment chapter. As detailed in the following paragraphs, the proposal encompasses more than the FTA because it includes matters relating to extraterritoriality, investment incentives, grandfathering of performance requirements in general (with prohibition of only those with trade-distorting impacts), and room for the development of new disciplines in related domains. The proposal comprises less than the FTA in its omission of grandfathering and ratchet concepts (it speaks only of enumeration of "acceptable deviations"), and its de-linkage (as a stand-alone investment agreement) from trade policy matters.

National Treatment and Right of Establishment

Graham and Krugman propose that a new agreement on international investment should contain a formal declaration of the basic rights and responsibilities of home nations, host nations, and multinational enterprises, including right of establishment and national treatment for local subsidiaries of foreign parentage. This suggestion is, of

---

[19] Edward M. Graham and Paul R. Krugman, Foreign Direct Investment in the United States (Washington D.C.: Institute for International Economics, 1989).

course, commendable; however, many countries have already subscribed to formal declarations respecting principles of fair and non-discriminatory treatment.

From the investment chapter of the Canada-U.S. FTA, it is clear that the elaboration and application of the "basic rights and responsibilities" will be the critical determinant of how well an agreement functions. For example, except as otherwise provided for, national treatment is accorded to investors of the parties to the agreement with respect to enumerated and defined measures (Article 1602). This approach stands in contrast to general statements on the applicability of national treatment found in many other investment agreements, including the OECD Codes. A second example is that the national treatment provision applies only to business once established. A right of establishment is not explicitly provided for, as Canada retains, under limited conditions, a right to review investments by U.S. investors.

"Acceptable Deviations"

The authors argue that the proposed agreement should enumerate "acceptable deviations" from basic rights and responsibilities (e.g., national security exemptions). This statement, of course, goes to the heart of any agreement. What are acceptable deviations? Should they be permanently ensconced or subject to periodic review? Based on the experience of the FTA, the following points could serve as guidelines for the content of an agreement:

- grandfathering of existing measures except where particular measures can be done away with or modified during the course of negotiations;
- provision for a ratchet mechanism for liberalization; and
- exemptions, but defined in precise terms.

Extraterritoriality

The Graham-Krugman proposal gives considerable weight to the need for provisions that address the extraterritorial application of a country's policies and laws. It asserts that:

> If the (foreign) subsidiary's efforts to obey local laws comes into conflict with directives from the parent company (perhaps to comply with laws or policies of the home government), obeying the local laws shall take precedence.[20]

---

[20] ibid., 127.

Two points should be made with respect to such a principle. First, extraterritorial application of laws and policies is currently subject to few accepted standards for alleviating or resolving any resulting disputes.[21] During the FTA negotiations, Canada attempted to place extraterritoriality on the negotiating agenda, but the U.S. refused to include the issue. The inclusion of new standards on extraterritoriality within a new investment agreement would be a departure from the FTA model.

Second, it may well be in the interests of the majority of G-7 nations, although probably not in the interest of the United States, to establish international standards and have recourse to dispute settlement in matters of extraterritoriality. Careful consideration and extensive background research would have to be given to the form such standards could take, particularly in light of the probable U.S. reluctance to engage in substantive negotiations on this issue area.

Reporting Requirements

Graham and Krugman propose that common standards for disclosure and reporting (perhaps along the lines of the Bryant Amendment) could be established that apply to all business enterprises exceeding a specified size threshold. This suggestion goes beyond the FTA, which provides only that: "Each Party may require an investor of the other Party . . . to submit to it routine information . . . solely for informational and statistical purposes."[22]

In considering this idea, it is useful to return for a moment to the relevant policy issue: the ability of governments to monitor economic activity within their jurisdictions. The policy rationales for such monitoring are several, most typically the need to detect anti-competitive behaviours and to secure sufficient data for the effective management of economic policy. In this regard, the reference of the proposal to the Bryant Amendment, which was strongly opposed even by the U.S. Administration as an unnecessary and discriminatory measure,[23] would appear to underline exactly the kind of measure a

---

[21] It should be noted that it is not evident that Graham and Krugman's principle is correct. For example, there may well be occasions where the extraterritorial application of policies and laws is unavoidable and even desirable. See: J.-G. Castel, Extraterritoriality in International Trade (Toronto: Butterworths, 1988).

[22] Article 1604, Canada-U.S. FTA.

[23] Sponsored by Representative John Bryant (D-Texas) and Senator Tom Harkin (D-Iowa), Bill S 289 and HR 5 — Foreign Ownership Data Disclosure — would have imposed extensive new reporting and broader disclosure of information about foreign holdings in the United States. The bill would have required foreign citizens acquiring 5 percent or more of a U.S. business or U.S. real estate to report on their investment to the Commerce Department. More detailed information would be required if they acquired more than 25 percent. The data would be available to state agencies, Congress, and the general public. In the event, however, the Administration opposed the bill. In late October, 1990, Congress passed a substitute

monitoring provision should attempt to overcome. Any monitoring provision should identify under what conditions and for what ends governments can collect data on foreign investors.

Performance Requirements

Graham and Krugman argue that there should be restrictions on the use of performance requirements and that the FTA provides an appropriate model for such restrictions: "New performance requirements that affect international trade are proscribed, whereas certain others are grandfathered."[24] However, the FTA actually prohibits enumerated performance requirements while others (including product mandate requirements and research and development requirements) are not grandfathered because they are not subject to the agreement. With this caveat, a new investment agreement could use the FTA performance requirements discipline. Indeed, during the negotiation of the accord there would very likely be pressure to increase the width and depth of such disciplines.

Investment Incentives

Graham and Krugman propose that investment incentives should be addressed in the investment agreement, a departure from the FTA model. Whether or not the inclusion of incentives would be appropriate would rest primarily on whether the MTN was judged to be effective for subsidies and relevant bilateral negotiations (e.g., the subsidy negotiations mandated by the Canada-U.S. FTA). Should progress prove elusive under such agreements, developing new disciplines on the use of investment incentives within the context of a new investment agreement could be a different and desirable approach.

Nearby Domains

Graham and Krugman propose that the investment agreement should provide for mechanisms for cooperation and future work with respect to such "nearby domains" as taxation, competition policy, and restrictive business practice matters. The FTA did not address these domains, nor did it set up any particular mechanism for work on them. As previously indicated in this paper, however, many (but not all) of the new multilateral investment policy issues are linked to these nearby domains. The fact that the FTA did not address them is a reflection of several factors, including the U.S. reluctance to

---

bill that was more narrowly targeted at coordinating and disseminating foreign investment data collected by diverse U.S. government agencies. This bill (S 2516) has the support of the U.S. administration.

[24] Graham and Krugman, Foreign Direct Investment, 127.

negotiate on these issues (especially extraterritoriality) and the priority accorded other concerns (e.g., Canada's formal barriers to investment) by the U.S. negotiators.

Dispute Settlement

The final element of a new investment agreement suggested by Graham and Krugman is that of a dispute settlement mechanism modelled on Chapter 18 of the FTA. A summary description of the Chapter 18 dispute settlement mechanism, together with other major international dispute settlement mechanisms relevant to investment, is contained in Annex B of this report. Table 2 contrasts the major elements of standing, process, and remedies of these mechanisms.

Table 2
Alternative Dispute Settlement Mechanisms

Instrument	Standing	Dispute Settlement Process	Remedies
FTA Chapter 18	Parties to the Agreement. Private parties can appear before panels.	Binding arbitration available upon mutual agreement of the parties, otherwise conciliation by the Trade Commission. Binding on safeguards.	Parties obligated to comply with the Trade Commission or arbitration decision. In event of non-compliance, benefits of equivalent effect may be suspended.
GATT	Signatories to the agreement.	Investigation by panels, findings submitted to council of signatories. Adoption based on consensus rule.	Unspecified.
ICSID	Investors of member countries and governments of member countries.	Conciliation or arbitration. No positive obligations to accept or reject results.	Unspecified.
OECD	OECD members.	Article 17 complaint mechanism. No positive obligations.	N/A

As indicated by Graham and Krugman, the FTA dispute settlement mechanism is clearly stronger than existing alternatives. While the overall structure of the FTA Chapter 18 mechanism stands as an attractive model for an international investment agreement, a number of design considerations would undoubtedly be raised, including:

- the precise nature of remedies to be made available;

- the standing of private parties to raise disputes independently of their governments;
- the composition and nature (permanent or ad hoc) of arbitration panels; and
- preconditions for reaching the dispute settlement phase. (e.g., is an actual breach or anticipated breach of undertakings required?)

Although the Graham-Krugman proposal is intriguing, it should be recognized that the main elements of Chapter 16 of the FTA are related to addressing transparent and formal barriers to direct investment. In fact, during the 1980s, such barriers had largely fallen into disuse in Canada. As a result, the United States obtained very little in terms of substantive change to the regulation of U.S. investment in Canada.

Given the complexion of the international investment environment today, it is not apparent that merely using the FTA investment provisions as the basis for a multilateral agreement would fully address the issues arising within that environment. More specifically, an accord based solely on the Chapter 16 FTA model would not address the central investment issues that increasingly overshadow, at least in the developed countries, such traditional investment concerns as the impact of foreign investment screening mechanisms.

NEGOTIATION OF A NEW ACCORD

This report has examined a number of developments in the international investment policy environment and the efficacy of existing multilateral instruments for achieving further liberalization of capital movements within that environment. The existing instruments have been effective in realizing the limited aims for which they were designed. In general, however, their usefulness has been largely exhausted, both with respect to the removal of formal and transparent barriers to investment and in addressing the new investment issues.

The Canada-U.S. FTA stands as one example (another being the European Economic Community) of how greater progress can be made in addressing trade and investment barriers, but within the context of a limited number of countries negotiating an agreement premised on the concurrent liberalization of trade and investment flows. For example, the review of the Investment Chapter of the Canada-U.S. FTA found that, taken out of the overall agreement, it held considerable merit as a model for a new multilateral investment accord, provided that such an accord was intended only to ensure that traditional barriers to investment were not to reappear as a significant issue for the developed economies. A broader instrument than a Chapter 16 agreement would be required to address the multifaceted investment policy issues of the 1990s.

What would be the primary characteristics of such a new instrument? First, the instrument could certainly enshrine the progress made to date on what we have termed — for want of a better label — the "traditional" barriers to investment. There is surely some potential, for example, to start where the OECD Codes have left off and ensure that slippage backwards (as recently occurred in the U.S. with the passage of Exon-Florio provisions of the 1988 Omnibus Trade Act) is prevented. This is essentially what Chapter 16 of the Canada-U.S. FTA accomplished.

Second, the omission of dispute settlement provisions from the OECD Codes is perceived by some commentators as one of the major weaknesses of the Codes. Chapter 16 of the FTA illustrates that progress could be made through provision for dispute settlement mechanisms to address investment issues. Of course, the design of such mechanisms for multilateral application would undoubtedly be more complex than in a strictly bilateral context.

Third, the instrument must be broad enough to embrace those areas which, although typically regarded only as "nearby domains" to investment policy, are in fact becoming central to the complexion of multilateral investment policy issues. To summarize the earlier discussion, critical questions would include:

- How best to characterize, for the purposes of a multilateral negotiation, those informal barriers to trade and investment that fall into the category of "structural impediments."
- How best to define desirable objectives to achieve with respect to the application of trade- and investment-related policies, particularly those innovation policies increasingly used in high technology fields.
- How best to design and incorporate the essential cross-walks between a new multilateral investment accord and new disciplines on investment-distorting trade measures.

As might be expected, the incentives for key potential signatories to subscribe to such a new investment accord vary considerably. For instance, Japan is increasingly concerned about the rising level of U.S. protectionism with respect to Japanese investments in the United States. The degree of Japanese concern has most recently been apparent in a public relations offensive aimed at demonstrating the openness of the Japanese economy to foreign investors and the contribution to the U.S. economy of Japanese investors.[25] Therefore, Japan might look with favour on a new international

---

[25] See, for example, "Successful Foreign-Affiliated Enterprises in Japan," Ministry of International Trade and Industry NR-374(90-3), (Tokyo: Overseas Public Affairs Office, January, 1990). Also, Japanese firms and the Japanese Ministry of Foreign Affairs are now pushing for increased tax breaks for Japanese subsidiaries overseas for charitable contributions. See Marcus W. Brauchli, "Japanese concerns push for tax breaks on charity abroad, but officials go slow," Wall Street Journal, February 23, 1990.

investment agreement aimed at protecting its investors from formal barriers to, and restrictions on, direct investment. Japan has few of these types of barriers and, therefore, taking part in the agreement would be relatively cost free. However, Japan might be more reluctant to engage in a negotiation that addressed broader market access issues that are tangentially rather than directly related to capital movements.

The U.S. Administration and Congress would be favourably inclined only towards a results-oriented investment agreement. The United States would be unlikely to enter into a new agreement unless it provided, directly or indirectly, a means to address long-standing market access issues.

The U.S. Congress would almost certainly reject any agreement that failed to contain substantive commitments by Japan and the European Community for the resolution of specific irritants. Such irritants might not, in the ordinary course of events, be characterized as "pure" investment issues. Moreover, with respect to the European Community, the U.S. Administration and Congress are both likely to view the prospect of a new investment accord within the larger strategic context of progress on the critical issue of agricultural subsidies.

The attitude of the European Community to an investment accord would be conditioned, in part, by the fact that they are already achieving substantial progress in the liberalization of capital movements between members of the Community. Removal of remaining formal barriers within the Community to third-party investors will not be a priority unless satisfaction is realistically achievable on the new investment issues vis-à-vis Japan.

The substance of any new multilateral investment accord cannot stand apart from considerations relating to its structure and shape. In this regard, three main options appear open to decision-makers at this time:

- an agreement within the forum of the OECD;
- a more ambitious accord that rests on an optimistic assessment of the future of the GATT; and
- an agreement initially negotiated between two of the three members of the Triad and which reflects a pessimistic assessment of the future of the GATT.

(a) An OECD investment agreement

This option is essentially that propounded by Graham and Krugman. It suggests that an investment agreement should, initially, involve only the world's largest industrial nations — members of the OECD — and could be based on many of the main elements of the investment chapter of the Canada-U.S. FTA:

> To involve a larger number of nations in setting the rules would be both impractical and unnecessary: impractical because the potentially common goals among the major industrial nations with respect to FDI differ markedly from the goals of most developing nations, and hence agreement on a common set of rules would be close to impossible; and unnecessary because the vast bulk of FDI at present takes place among a relatively small number of industrially advanced nations. Nonetheless, it should be made possible for nations outside the core group eventually to sign the FDI accord as well; some less-developed countries, and notably some of the newly industrialized countries, might be willing to do so.[26]

The OECD could be an attractive forum for the negotiation of a new investment accord. As an institution, it has a considerable knowledge base on areas critical to negotiations on the new investment issues — especially competition policy and, to a lesser extent, innovation policy. Moreover, as an institution, the OECD has largely been absent from the Uruguay Round of the Multilateral Trade Negotiations (MTN) and, therefore, could be viewed as a more neutral forum for discussions that would necessarily touch on issues raised during the MTN.

(b) A World Trade Organization agreement

This option is based on the assumption that a policy agenda for both trade and investment cannot be adequately housed within the confines of the existing GATT system. Instead, a World Trade Organization (WTO) could be the institutional mechanism for overseeing the development of a new investment code that is integrated with, or complementary to, rules governing the international trade system.

A Canadian proposal for a World Trade Organization was announced in April of 1990. The proposal conceives of the WTO as an institutional umbrella for agreements negotiated under the GATT as well as "potential other new trade and investment agreements." It is premised on the belief that:

> There is justifiably serious concern whether the GATT can cope adequately with the future of international trade relations. Indeed, a successful substantive outcome of the Uruguay Round will add greatly to the complexity of the GATT system, to its institutional burdens and to the public understanding of the importance and the operation of that system.[27]

---

[26] Graham and Krugman, Foreign Direct Investment, 125-26.

[27] "Proposal for a World Trade Organization: Concept and Perspective", internal briefing note, Department of External Affairs and International Trade, Multilateral Trade Negotiations Branch, August, 1990. See also: John H. Jackson, Restructuring the GATT System (New York: Council on Foreign Relations Press, 1990).

A World Trade Organization could also transcend the weaknesses of a stand-alone investment agreement. Moreover, broader issues could be considered, including:

- consideration of investment-distorting trade measures as well as the traditional investment issues;
- application of new and more rigorous dispute-settlement mechanisms, perhaps based on existing FTA or GATT precedents;
- linkages that can be made between trade liberalization and capital liberalization initiatives; and
- inclusion of LDCs and industrialized countries in a single forum for the negotiation of investment issues.

This last point is deserving of further elaboration. Graham and Krugman correctly pointed out the divergence between the interests of many LDCs and those of the industrialized world with respect to investment policies. Within the forum of the GATT, however, the Most Favoured Nation rule has been modified on occasion to provide for a conditional MFN. Under the auspices of a WTO, a rigorous investment code could be negotiated between a smaller group of industrialized nations on a conditional MFN basis.

(c) Investment accords between trade blocs

A third and more radical option (perhaps "potential development" is a more accurate label) lies in the negotiation of substantive investment accords within the context of free trade areas created between two of the three emerging trade blocs. Such a development might see, for example, Europe and North America negotiating a North Atlantic free trade area, including a comprehensive agreement on investment, as a means of addressing trade and investment issues with Japan.

Unlike options (a) and (b) above, this option is based on the belief of the inherent instability of a three-party sharing of economic power. The possibilities have been outlined, although not supported, by C. Fred Bergsten in the following terms:

> In the United States, there is a widespread view that conflict among the Big Three would evolve into an alliance between America and Europe against Japan. Japan would be viewed as an outlier on both trade and investment issues, and thus a target for the other industrial, and perhaps many developing, countries. Racial overtones would be widely perceived even if unintended.
>
> A second possibility is that the United States and Japan would band together against a united Europe. If Europe is the only true bloc, and thereby becomes the world's largest and most powerful economic entity, the other global actors may need to coalesce against it for traditional balance-of-power reasons. Such an

> outcome would be much more likely if Europe were to turn inward and to discriminate overtly against outsiders.
>
> Americans need to be aware, however, of a very plausible third possibility: a European-Japanese nexus. These regions are likely to enjoy higher growth rates than America during the coming critical transitional period — perhaps by a substantial margin.[28]

Bergsten concludes that any of these possibilities as permanent configurations would be extremely destabilizing for global politics as well as for economic affairs.

[28] Bergsten, "The World Economy," 96-112.

CONCLUSION

International investment policy issues for the 1990s will have a significantly different complexion than in the forty years following the second world war:

- Transparent barriers to direct investment have largely been dismantled or have fallen into disuse among OECD countries, although they remain in place in many LDCs.
- New investment issues relate to the implications of national trade policies, structural differences between national economies, and the effects of competition policies and innovation policies.
- Foreign direct investment is increasingly important to individual corporations as they extend their global reach.

While the objective of liberalizing capital flows remains relevant in the 1990s, it may not be achievable through traditional approaches. If a new multilateral investment accord is to be negotiated, it should address both the traditional barriers to direct investment and the new investment issues. Existing multilateral instruments for addressing the investment policy issues at hand are not adequate.

Canadian decision-makers should give careful consideration to the implications for Canada of potential alternative multilateral arrangements. Key considerations would include the following:

- The OECD could well serve as an attractive alternative location for negotiations on a new investment agreement, at least from a Canadian perspective. Not only has Canada considerable experience in negotiating within that forum, but the OECD is a more neutral site for the consideration of investment issues than the MTN (where developed-developing country conflicts forestall substantive agreements). However, it is not evident that political incentives exist to give the OECD such an expanded and ambitious role.
- The concept of a World Trade Organization has not received strong support by the key players (Japan, Europe and United States), although Canada's stated preference has been for placing investment directly under the auspices of a WTO.
- Although a number of options are feasible that build on existing multilateral instruments (i.e., the GATT or the OECD), they may not seem attractive to potential participants should policy-makers perceive economic dominance on the world scene by the Triad. In the event of a destructive round of economic warfare among members of the Triad, an agreement on

investment could serve as a method of achieving national political ends rather than a genuine attempt to meet the economic requirements posed by the forces of globalization. Moreover, there is some possibility that two members of the Triad could use an investment accord as a political lever to achieve larger economic objectives from a third member. Of the three options, this could place Canada in a most disadvantageous position, as Canada's negotiating leverage would likely be minimal.

Appendix A
STATUS AND PURPOSE OF SIGNIFICANT MULTILATERAL INVESTMENT ARRANGEMENTS AND AGREEMENTS

Specialized Agencies and Facilities

The 1965 International Convention on the Settlement of Investment Disputes (ICSID) between States and Nationals of other States, provides facilities, under the auspices of the World Bank, for the conciliation or arbitration of investment disputes between contracting states and nationals of other contracting states. There are now 91 members, with the People's Republic of China signing the Convention on February 9, 1990. Canada has not yet signed the Convention. To date, only 26 cases have been brought before ICSID, almost all of which involved disputes between a national of an industrialized country and the government of a developing country. However, a large number of governmental and non-governmental agreements make reference to ICSID for dispute settlement.

The convention establishing the Multilateral Investment Guarantee Agency (MIGA) became effective in April of 1988. MIGA seeks to improve the investment environment in LDCs by providing foreign investors a financial guarantee against non-commercial risks. The facilities provided under ICSID and MIGA constitute targeted measures to address specific problems largely, although not entirely, related to the economic relationships between the industrialized nations and LDCs. One recent U.S. government assessment of MIGA has pointed out that the institution's mandate is not to establish uniform standards of conduct for investors or host governments, but rather to act as an intermediary to assist them in harmonizing their relationship.

UN Draft Code of Conduct on Transnational Corporations

The United Nations Draft Code of Conduct on Transnational Corporations is intended to provide:

> . . . a stable, predictable and transparent framework that would facilitate the flow of resources across national boundaries and thereby enhance the role of foreign investments in economic and industrial growth. At the same time, the Code is meant to minimize any negative effects associated with the activities of transnational corporations.

The Code has been under development since 1977, but is still in draft format. Negotiations have bogged down in such diverse but fundamental issues areas as national treatment, dispute settlement and overall objectives of the Code.

Bilateral Investment Treaty Programs

Over 265 bilateral investment treaties (BITs) have been concluded since the 1960s. Several analyses have indicated that this extensive network of treaties is characterized by the following features:

- The majority of the treaties have been signed between market-economy countries and developing countries although, more recently, socialist countries have become parties to BITs.
- The treaties tend to re-state traditional principles of customary international law with respect to the treatment of foreign property abroad.
- As the negotiation of bilateral investment treaties has stemmed primarily from the desire of capital exporters to protect their property abroad, the treaties have come under considerable criticism by capital importers as being inherently biased in favour of capital exporters.

In October of 1989, Canada initiated its own bilateral investment treaty program known as the Foreign Investment Protection Agreement (FIPA). Canada's first FIPA was signed with the Soviet Union on November 20, 1989 and would appear to follow, in intent and content, the general international Bilateral Investment Treaty models. The agreement provides for MFN treatment of investments made by nationals of one party in the territory of the other, for prompt and fair compensation in cases of expropriation or nationalization, for the transfer of funds in convertible currency, and for a dispute settlement mechanism.

OECD Codes of Liberalization

The OECD Codes of Liberalization are legal instruments that provide for progressive liberalization in international capital movements and invisible operations. These Codes have been updated from time to time to deal with emerging changes in economic life. They are set up to encourage a multilateral approach, in contrast to bilateral agreements which emphasize reciprocity and national treatment. With Canada's adherence to the Capital Movements Code in 1985, all 24 members of the OECD have agreed to adhere to the Codes.

According to the Department of External Affairs and International Trade, since its adherence to the Codes in 1985 Canada has been under pressure to limit its reservation on inward direct investment. In March 1991, Canada announced its decision to replace its full reservation with a set of limited reservations in those sectors where Canada has restrictions (e.g., financial services and transportation) as well as for the Investment Canada review process. In addition, consideration is being given within the Committee on Investment and Multinational Enterprises (CIME) to strengthening the National

Treatment Instrument by making the granting of national treatment to foreign-controlled enterprises obligatory, with certain exceptions (e.g., essential security interests).

The GATT

Investment was placed on the agenda of the Multilateral Trade Negotiations in the fall of 1986 when Ministers agreed that: "Following an examination of the operation of GATT Articles related to the trade restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade."

Negotiations within the trade-related investment measures (TRIMs) group have been proceeding very slowly, with a north-south split in evidence. In general, the LDCs, particularly India and Brazil, have taken the position that no investment policy instruments except TRIMs should be discussed and, even with respect to TRIMs with a discernable trade impact, these should be examined in the broader context of restrictive business practices.

The United States, backed by the EC, the Nordic countries, Japan and Switzerland, have argued in favour of prohibitions on performance requirements, although there is some disagreement on precisely which requirements should be subject to prohibition. The Nordic proposal, submitted in November of 1989, argues that only local content and export performance requirements are "sufficiently clear-cut in their trade distorting effect" that they should be eliminated. The EC proposal suggests that the following eight areas should be addressed: local content requirements, manufacturing requirements, domestic sales requirements, trade-balancing requirements, exchange restrictions, product-mandating requirements, manufacturing limitations with respect to components, and export performance requirements.

Most commentators believe that substantive negotiations on TRIMs will not take place until the end of the Uruguay Round negotiations. At this time, and despite public pronouncements of the importance of an investment agreement, the United States is taking a non-aggressive stance. In summary, the negotiation on TRIMs is not a priority item among any of the signatory parties. As a result, the final outcome may well consist of only a statement of good intentions rather than a commitment to the prohibition of a long list of performance requirements.

Appendix B
DISPUTE SETTLEMENT MECHANISMS

FTA - Chapter 18

The general dispute resolution mechanism in the FTA, as laid out in Chapter 18, places an emphasis on prior notification and consultation. Each party must provide prior written notice to the other of any proposed or actual legislation, regulation, governmental procedure, requirement or practice that might materially affect the operation of the FTA. Only the parties to the Agreement have standing to initiate the dispute resolution mechanisms under Chapter 18. As far as any conflicts in the area of investment are concerned, binding arbitration would only be available by mutual agreement of both parties. In the absence of mutual agreement, the Commission would be left to deal with the problem following the appropriate period of consultation between the parties. A panel of experts may be appointed that will hold appropriate proceedings, following which recommendations are made to the Commission which, in turn, is mandated to agree on a resolution of the dispute. The parties are obligated to comply with any decision flowing from the Commission or binding arbitration. In the event of non-compliance, the damaged party may suspend benefits of equivalent effect to the other party until a resolution of the dispute.

GATT

There is no single, clearly defined dispute settlement procedure in the GATT. Rather, specific procedures have been set up to deal with allegations of violations of specific GATT clauses. In general, a complaint is lodged by one of the contracting parties. The next step is for a panel to be appointed or the matter to be referred to an already existing Panel on Complaints. The final step is for the panel to submit a report and any appropriate recommendations to the GATT Council of Signatories. A consensus rule allows any contracting party to block adoption of the panel's final recommendations, a major shortcoming in the system. Another major problem lies in the fact that there is no definite time limit on the organization of Dispute Resolution Panels or upon the Council of Signatories' consideration of a Panel's final report and recommendations.

OECD

The OECD Codes of Liberalization contain no formal dispute resolution mechanism. Article 16 of the Code of Liberalization of Capital Movements provides that a member may refer a complaint to the Organization if it considers itself prejudiced by an internal arrangement of a fellow member that has the effect of restricting transactions or transfers. If the OECD determines that the internal arrangements concerned have the effect of frustrating its measures of liberalization, it may make suitable suggestions with

regard to the removal or modification of such arrangements. Article 17 provides a similar complaint mechanism as far as any restrictions on capital movements or the use of non-resident-owned funds are concerned. This does not preclude a member from entering into bilateral conversations on the matter with the other member concerned. Pursuant to Article 23 of the Code, any member may withdraw from the Code by providing the Organization with sufficient notice (12 months from the date on which such notice is received).

International Convention on the Settlement of Investment Disputes (ICSID)

ICSID deals with the settlement of international investment disputes between investors of a member country and the government of another member country. The Centre for the Settlement of Investment Disputes maintains a permanent panel of conciliators and arbitrators from which the parties to a dispute may choose to form either a Conciliation Commission or Arbitration Tribunal. Disputes are settled on the basis of the written submissions of the parties. There are no positive obligations imposed on members as regards the settlement of disputes, as it remains open to any party to accept or reject the conciliation or arbitration organized under the Convention. It is also open to any member state to give notice at any time that it would not consider submitting to the jurisdiction of the Centre on any class or classes of disputes. All Commission or Tribunal decisions are binding on the parties and are not subject to any appeal or to any other remedy except as provided for in the Convention (i.e., revision or annulment). Canada is the only G-7 country that has not joined the Convention.

INVESTMENT CANADA WORKING PAPER SERIES

1. **CANADIAN MINORITY EQUITY PARTICIPATION IN FOREIGN CONTROLLED SUBSIDIARIES**

   Working Paper Number 1 - 1990. Prepared by Investment Canada Research and Policy Staff.

2. **SUBSIDIARY STRATEGY IN A FREE TRADE ENVIRONMENT**

   Working Paper Number 2 - 1990. Professor Harold Crookell (University of Western Ontario) under contract with Investment Canada.

3. **FORMATION AND OPERATION OF JOINT VENTURES IN CANADA**

   Working Paper Number 3 - 1990. Dr. J. Michael Geringer (University of Western Ontario) under contract with Investment Canada.

4. **TRENDS AND TRAITS OF CANADIAN JOINT VENTURES**

   Working Paper Number 4 - 1990. Dr. J. Michael Geringer (University of Western Ontario) under contract with Investment Canada.

5. **THE BUSINESS IMPLICATIONS OF GLOBALIZATION**

   Working Paper Number 5 - 1990. Incorporates contributions made by Dinah Maclean (Grady Economics and Associates Ltd.) under contract with Investment Canada.

6. **INTERNATIONAL INVESTMENT: CANADIAN DEVELOPMENTS IN A GLOBAL CONTEXT**

   Working Paper Number 6 - 1990. Prepared by Investment Canada Research and Policy Staff.

7. **THE OPPORTUNITIES AND CHALLENGES OF NORTH AMERICAN FREE TRADE: A CANADIAN PERSPECTIVE**

   Working Paper Number 7 - 1991. Prepared by Investment Canada Research and Policy Staff and Ron Hood (R.D. Hood Economics Inc.) under contract with Investment Canada.

8. A MULTILATERAL INVESTMENT ACCORD: ISSUES, MODELS AND OPTIONS

Working Paper Number 8 - 1991. Prepared by Strategico Inc. under contract with Investment Canada.

FOR COPIES, CONTACT: Publications Officer
Investment Research and Policy,
Investment Canada
P.O. Box 2800, Station D
Ottawa, Ontario, K1P 6A5
Tel: (613) 995-9603
(613) 995-7077